

## The Impact of the EU Securitization Regulation on US Entities

The next phase of the European Union's (the "EU") new regulatory regime for securitizations will become applicable from January 1, 2019 pursuant to Regulation (EU) 2017/2402 (the "Securitization Regulation"). The Securitization Regulation revises and consolidates the existing rules relating to securitizations,<sup>1</sup> including with respect to risk retention, disclosure and credit-granting, and introduces a ban on resecuritization. It also specifies criteria that a securitization will need to satisfy if the parties want the transaction to be designated as a simple, transparent and standardized ("STS") securitization. Like past phases of EU regulation regarding securitizations, such as the Capital Requirements Regulation (the "CRR"), the Securitization Regulation does not directly require compliance by United States ("US") entities participating in securitization transactions (except in certain cases where they are subject to supervision on a consolidated basis with an EU regulated institution). However, the Securitization Regulation may indirectly result in US securitization originators, sponsors and securitization special purpose entities ("SSPEs") being required to provide additional disclosure in order for EU institutional investors to be able to invest in US securitization transactions.

### Investor Due Diligence Requirements

EU institutional investors will need to comply with the due diligence requirements of the Securitization Regulation in order to invest in a securitization transaction with a US originator or sponsor. Article 5 of the Securitization Regulation imposes both initial and ongoing due diligence requirements on EU institutional investors. Prior to investing in a

securitization transaction, an EU institutional investor must carry out a due diligence assessment that considers risk characteristics, material structural features and, if applicable, compliance with the criteria for STS securitizations. An institutional investor must also verify compliance with credit granting standards, EU risk retention requirements and, where applicable, the transparency requirements provided in Article 7 of the Securitization Regulation. After making an investment in a securitization transaction, an EU institutional investor has an ongoing obligation to monitor the compliance and performance of the transaction pursuant to written procedures established by the investor and to meet continued reporting and testing requirements.

Currently, under the CRR, EU institutional investors that invest in securitization transactions with US entities are already required to meet due diligence assessment and monitoring standards. Other than the reference to the transparency requirements in Article 7, which are discussed below, the Securitization Regulation due diligence requirements are substantially similar to (but not the same as) the CRR due diligence requirements. In recent years, many US entities have already undertaken limited voluntary compliance with the CRR in order to make their securities eligible for purchase by EU investors and already provide disclosure with regard to underwriting standards and risk retention that could be sufficient to allow an EU institutional investor to meet the related due diligence requirements of the Securitization Regulation.

## Ambiguity Remains as to Application of the Transparency Requirements of the Securitization Regulation to US Entities

Article 7 of the Securitization Regulation establishes transparency requirements for originators, sponsors and SSPEs, requiring certain specified information and documentation to be provided to investors, supervisory authorities and, upon request, potential investors in a securitization transaction. Originators, sponsors and SSPEs must make available all the underlying documentation that is essential for understanding the transaction, together with a prospectus, or where there is no prospectus, a transaction summary. They are also required to report certain significant events and to meet ongoing regular reporting requirements, which require that certain loan-level information regarding the assets underlying a securitization transaction be provided on specified reporting templates to be established pursuant to technical standards.<sup>2</sup>

While there is some overlap between the general information required by Article 7 and the information required by Regulation AB for US Securities and Exchange Commission publicly registered transactions, which is also typically included in offering memoranda for unregistered US term issuances, providing the loan-level information specified in the reporting templates is beyond the scope of Regulation AB. Providing this additional data is expected to be costly and burdensome for US entities. As a result, the question whether a US originator, sponsor or SSPE must provide the information required by Article 7 when selling securitization exposures to EU institutional investors is one of the most important interpretive issues raised by the Securitization Regulation for US originators and sponsors.

While the jurisdictional scope of Article 7 is not specified, we believe that originators, sponsors and SSPEs that are not established in an EU member state should not generally be directly subject to the transparency requirements of the Securitization Regulation.<sup>3</sup> As discussed below, this interpretation is supported by certain provisions of the

Securitization Regulation and other principles of interpretation.

Article 1(2) of the Securitization Regulation indicates that the Securitization Regulation applies to institutional investors, originators, sponsors, original lenders and SSPEs, but the Securitization Regulation does not explicitly state that it only applies to such parties if they are established in the EU.<sup>4</sup> However, in certain provisions of the Securitization Regulation a distinction is drawn between an originator or sponsor “established in the Union” and one “established in a third country.” For example, the due diligence verification requirements in Article 5(1) with respect to credit-granting and risk retention<sup>5</sup> provide one verification standard if the relevant entity is “established in the Union” and a comparable but separate verification standard if the relevant entity is “established in a third country.” Furthermore, related EU regulations like the CRR have similarly been interpreted as not imposing direct obligations on non-EU entities.

With respect to the obligation in the Article 5 investor due diligence requirements to verify compliance with the transparency requirements of Article 7, the phrase “where applicable” in the section of the Securitization Regulation imposing the obligation suggests that Article 7 is not applicable in all instances.<sup>6</sup> One interpretation of this language would allow EU institutional investors to conclude that the requirement to verify compliance with certain of the transparency requirements (including potentially burdensome loan-level data requirements) is not applicable with respect to US originators, sponsors or SSPEs because the Securitization Regulation does not directly apply to non-EU entities.

If the market adopts this interpretation, it is not likely that the Securitization Regulation will result in a significant increase in the amount of information requested from US entities by EU institutional investors. However, we are aware of different views on this point. Each EU institutional investor will need to make an independent assessment regarding its own compliance with the due diligence requirements under the Securitization Regulation,

and some EU investors may determine that the requirement to verify compliance with the transparency requirements under Article 7, including the provision of loan-level data, is applicable with respect to US originators, sponsors and SSPEs.

### The Securitization Regulation Should Not Impact EU Investor Participation in Most Pre-2019 Transactions

The Securitization Regulation will not apply to transactions entered into before January 1, 2019 unless new securities are issued or a new securitization position is created on or after that date. Therefore, the Securitization Regulation is not expected to impact the liquidity of previously issued transactions as long as they remain grandfathered; an EU institutional investor can still invest in securitizations issued prior to January 1, 2019 even if those transactions do not comply with the Securitization Regulation. The Securitization Regulation does not make clear how its provisions should be applied to master trust structures where different series of securities may be issued before and after the Securitization Regulation becomes effective. While it could be argued that each series issued by a master trust is a separate securitization, we understand that the prevailing market view is that the master trust constitutes a single securitization such that the new issuance of a series after the Securitization Regulation becomes effective will subject the entire master trust to the Securitization Regulation. While not made clear in the Securitization Regulation, the market view is that, in that instance, an EU institutional investor's existing investment in a pre-2019 series would be considered compliant even if not in compliance with all aspects of the Securitization Regulation. However, an EU institutional investor investing in a pre-2019 series of a master trust that issued a series in 2019 would potentially need to assess compliance under the Securitization Regulation.

### Potential Impact on Warehouse Facilities and Conduit Arrangements with EU Banks

An EU bank that is a lender to a US originator or SSPE in a warehouse facility or through a variable funding note will be required to comply with the Securitization Regulation if the transaction falls within the definition of a securitization. If that EU bank lender is funding its advances directly, then it will be subject to the due diligence requirements of the Securitization Regulation as discussed above, and the disclosure of loan-level data by the US originator or SSPE using the applicable reporting templates could be required. If the advances are being funded through an ABCP program for which an EU bank acts as sponsor, then that EU bank will itself be subject to the transparency requirements imposed on sponsors by Article 7. In order to comply with its own obligations under Article 7, the EU ABCP sponsor may require its US counterparty to provide certain information that the ABCP sponsor could aggregate for use in its program-level disclosure to ABCP investors (depending on what is required to be reported by the ABCP sponsor in the final form of the reporting templates for ABCP securitizations). Loan-level data also may need to be made available to the ABCP program sponsor.<sup>7</sup> US originators should discuss with their EU bank lenders and ABCP sponsors what data they will require for compliance.

### A US Sponsored Transaction Cannot Qualify as an STS Securitization

A transaction cannot qualify as an STS securitization unless the originator, sponsor and SSPE are all established in the EU. It is possible that certain EU institutional investors will have more interest in investing in STS securitizations than non-STS securitizations after the Securitization Regulation becomes effective. Institutional investors may find STS securitizations more attractive due to lower regulatory capital requirements compared with non-STS securitizations, or they may take the view that an investment in an STS securitization would be more liquid. Therefore, transactions with US entities may be less marketable than STS securitizations. It is not

yet clear what proportion of securitization transactions will be STS securitizations, but it is expected that there will still be a market with EU institutional investors for non-STS securitizations, including non-STS securitizations with US entities.

## Conclusion

While the Securitization Regulation does not directly impose obligations on US entities involved in securitization transactions, US originators, sponsors and SSPEs may be asked to provide additional information to EU institutional investors and sponsors of ABCP conduits. Ambiguity remains as to whether the transparency requirements of Article 7 will lead EU institutional investors to request significant additional information from US sponsors, including loan-level data. If this ambiguity is resolved in favor of not requiring US sponsors to provide such information, the Securitization Regulation would not be expected to impose significant additional burdens on US sponsors or significantly reduce the market in the EU for investment in securitization transactions sponsored by US entities. However, the extent to which EU institutional investors will impose the loan-level data requirements of the Securitization Regulation on US entities remains to be seen.

## Endnotes

- <sup>1</sup> The Securitization Regulation defines securitisation broadly to mean any “transaction or scheme, whereby the credit risk associated with an exposure or a pool of exposures is tranching,” having certain enumerated characteristics. See Article 2(1).
- <sup>2</sup> The European Securities and Markets Authority (“ESMA”) published its final draft of the technical standards with respect to the detailed reporting requirements and the associated templates in August 2018. However, market participants have expressed a number of concerns about the templates. The European Commission has notified ESMA that it intends to endorse the draft technical standards only once certain amendments are introduced and has requested ESMA to consider whether the “No Data” option could be available for additional fields of the draft templates, particularly with respect to the templates

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for ABCP securitizations. See <https://www.esma.europa.eu/document/european-commission-letter-esma-draft-rtis-and-its-securitisation-disclosures>. The Securitization Regulation requires that, in the event that the new technical standards are not in place by January 1, 2019, the reporting templates established pursuant to Article 8b of the Credit Rating Agencies Regulation be used in the interim period. See Regulation (EC) No 1060/2009 on credit rating agencies, as amended, including by Regulation (EU) No 462/2013. It is anticipated that national supervisors will exercise their powers in a proportionate and risk-based manner during that period taking into account the type and extent of information already being disclosed by reporting entities, on a case by case basis. See the joint statement of the

European Supervisory Authorities at [https://esas-joint-committee.europa.eu/Publications/Statements/JC\\_State\\_ment\\_Securitisation\\_CRA3\\_templates\\_plus\\_CRR2\\_final.pdf](https://esas-joint-committee.europa.eu/Publications/Statements/JC_State_ment_Securitisation_CRA3_templates_plus_CRR2_final.pdf).

- <sup>3</sup> Note that certain non-EU subsidiaries of EU banking entities that are subject to consolidated supervision under the CRR could become subject to the requirements of the Securitization Regulation directly. However, it is expected that the rules will be amended to limit the application of these requirements with respect to these non-EU entities to the due diligence requirements. EU competent authorities are expected to take this pending amendment into account when assessing compliance with the Securitization Regulation. See the joint statement of the European Supervisory Authorities at [https://esas-joint-committee.europa.eu/Publications/Statements/JC\\_State\\_ment\\_Securitisation\\_CRA3\\_templates\\_plus\\_CRR2\\_final.pdf](https://esas-joint-committee.europa.eu/Publications/Statements/JC_State_ment_Securitisation_CRA3_templates_plus_CRR2_final.pdf).
- <sup>4</sup> The term “institutional investor” is defined in Article 2(12) by reference to entities that are defined in or fall under certain EU regulations that are only applicable to EU investors. Therefore, only institutional investors that are established or located in the EU will be required to comply with the Securitization Regulation. The definitions of “securitization special purpose entity,” “originator,” “sponsor” and “original lender” contained in Article 2 are not limited to entities in the EU.
- <sup>5</sup> The credit-granting and risk retention requirements are similar (but not identical) to the requirements in the CRR.
- <sup>6</sup> See Article 5(1)(e): “Prior to holding a securitisation position, an institutional investor, other than the originator, sponsor or original lender, shall verify that:... the originator, sponsor or SSPE has, *where applicable*, made available the information required by Article 7 in accordance with the frequency and modalities provided for in that Article.” (emphasis added).
- <sup>7</sup> See Article 7(1): “In the case of ABCP, the information described in points (a), (c)(ii) and (e)(i) of the first

subparagraph shall be made available in aggregate form to holders of securitisation positions and, upon request, to potential investors. Loan-level data shall be made available to the sponsor and, upon request, to competent authorities.”

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